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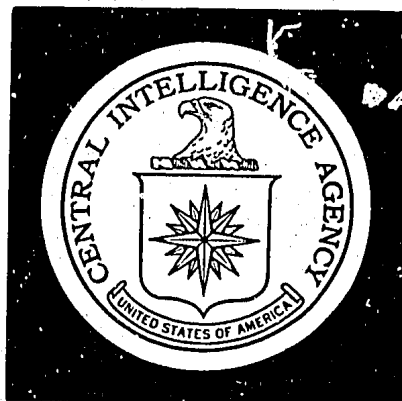
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DIRECTORATE OF  
INTELLIGENCE

# Intelligence Memorandum

*International Finance Series No. 31*

*The World Gold Market: A Semiannual Review*

**Secret**

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September 1971

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CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
September 1971

INTELLIGENCE MEMORANDUM

THE WORLD GOLD MARKET:  
A SEMIANNUAL REVIEW

Introduction

1. This memorandum, one of a series begun shortly after the two-tier market was established in March 1968, reviews and updates developments in both the official and private tiers through August 1971, the month President Nixon suspended United States support of the official tier. Attention is focused on South African sales and the free market price for gold.

Highlights

2. US monetary gold stocks fell \$864 million in 1971 before President Nixon closed the gold window on 15 August. West European nations accounted for the lion's share of these purchases.

3. South Africa apparently continues to sell virtually all its newly-mined gold on the free market through the Swiss consortium headed by the Union Bank of Switzerland. During the first eight months of 1971, such sales averaged about 80 metric tons per month.

4. Free market prices climbed somewhat erratically during the period under review, accelerating with the West German decision on 9 May to float the mark. During August, free market prices fell from almost \$44 per fine ounce, their highest level since the establishment of the two-tier system, to about \$42 per ounce.

The Official Market for Gold

5. By the time President Nixon closed the official gold window on 15 August, US monetary gold reserves had fallen to their lowest level since 1935. In the first eight months of 1971, US gold reserves declined \$864 million to \$10.2 billion. Although more than 30 countries purchased US

*Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.*

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gold during this period, nine countries accounted for almost 97% of the total (see Table 1). France, as part of a repayment of its debt to the International Monetary Fund (IMF), made two purchases totaling \$473 million. The Swiss, convinced that their dollar holdings were too large, took another \$175 million; for the same reason Belgium acquired \$110 million. In addition, the United States, in its role as a gold supplier for other countries seeking additional amounts of gold to cover their gold tranche increases, sold \$22 million to the IMF. Only two countries, Burma and Turkey, sold gold to the United States. Both have been experiencing balance-of-payments difficulties.

Table 1

United States Official Gold Transactions  
1 January-15 August 1971

Million US \$		
<u>Country</u>	<u>Sales by the United States</u>	<u>Purchases by the United States</u>
Burma		41.9
Turkey		14.6
France	473	
Switzerland	175	
Belgium	110	
Lebanon	35	
Singapore	30	
Netherlands	25	
Finland	20	
Turkey	11.7	
Malaysia	10.0	
Others	8.7	
IMF	22	
<i>Total</i>	920.4	56.5
<i>Net</i>		863.9

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South African Gold Sales

6. South Africa continued to sell substantial quantities throughout the period. Virtually all newly-mined output – valued at approximately \$736 million – was placed in the free market, and another \$147 million, \$142 million from official South African gold stocks, was sold to monetary authorities. The IMF purchased \$135 million of the \$147 million: (a) \$105 million under the "deficit formula" that permits South Africa to sell gold to the IMF to finance balance-of-payments deficits remaining after sales of newly-mined gold, and (b) \$30 million owed by Pretoria for an increased gold subscription resulting from a larger quota. The remaining \$12 million was composed of sales to Switzerland as its counterpart of sales to the IMF, to the Bank for International Settlements for South Africa's initial subscription payment, and to Mozambique in an agreement to repatriate earnings by its residents working in South African gold mines. As a result, by 31 August 1971, South African gold reserves had been reduced to \$486 million (see Table 2).

The Free Market for Gold

7. South Africa's free market sales during the first eight months of 1971 totaled \$724 million (calculated at \$35 per troy ounce of fine gold), and approximately equalled newly-mined output. As in the past, almost all of this gold eventually found its way to the consortium of three commercial banks in Zurich headed by the Union Bank of Switzerland. An estimated 60% of the consortium total was purchased f.o.b. Johannesburg and flown to Zurich aboard aircraft operated by Balair, a Swissair subsidiary. The remainder, shipped by sea to England, was subsequently flown from London to Zurich.

8. Free market gold prices, which began the year well below \$38 per troy ounce, experienced a relatively steady increase through the first four months of the year (see the chart), with the second London fixing set at \$39.70 on 30 April. Uncertainty concerning the US economy with its growing trade deficit, substantial churning of Eurodollar accounts, and large dollar inflows into European central banks spurred speculative demand for gold.

9. In early May, to curb inflationary pressures that were exacerbated by dollar inflows, the West Germans set the mark free to find its own level. The dollar remained weak in the foreign exchange markets, however. The free market price of gold rose above \$41 per ounce in late May. Although the free market price subsequently fell back below \$40 per ounce, in mid-June it resumed its climb, reaching \$43.94 on 9 August. Following President Nixon's speech on the economy, speculators began to accept that the price of gold would not be altered, and the free market price declined

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Table 2

South African Gold Reserves  
31 August 1971 a/

	Million US \$
Reserves as of 31 December 1970 <u>b/</u>	628
Estimated production (January- 31 August 1971)	736
Estimated total before sales	<u>1,364</u>
Less sales	
To the IMF (under deficit formula of the December Agreement)	135
To other monetary authorities	12
On free market	724
Total sales	<u>871</u>
Estimated reserves after sales	493
Reserves as of 31 August 1971	486
Unexplained difference <u>c/</u>	7

*a. For consistency in analyzing reserve data, values are calculated at \$35 per troy ounce of fine gold.*

*b. Including an adjustment for a gold sale in the first week of January 1971, which is considered as having taken place in 1970.*

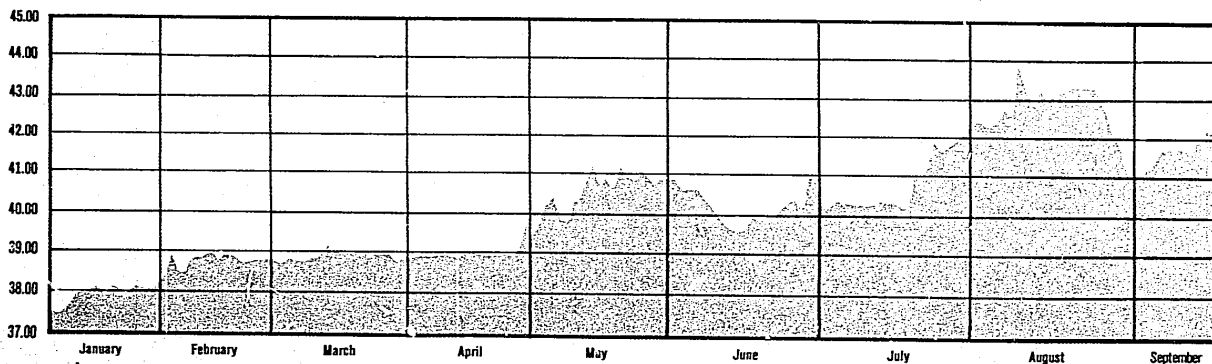
*c. This discrepancy probably is explained largely by differences in reporting periods. Sales figures are weekly, ending 27 August, while reserve data are monthly, ending 31 August.*

to \$40.65 per ounce at the end of August. But in September, renewed uncertainty surrounding the future of the international monetary system led gold prices to surpass \$42 per ounce.

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# London Daily\* Gold Prices, 1 January -17 September 1971

US \$ Per Troy Ounce of Fine Gold



\*Second Fixing

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Soviet and East European Gold Sales

10. The Soviet Union sold approximately \$20 million worth of gold in the free market during the first half of 1971, probably all in Switzerland. The USSR presumably was testing the free market. Since then there has been no further evidence of Soviet sales. Reported gold trading by East European countries has been minor, usually in amounts of about \$1 million.

Outlook

11. South Africa's balance-of-payments deficit after counting sales of newly-mined gold as exports will be an estimated \$100 million for the second half of 1971. This is principally the result of a reduction of the current-account deficit from about \$1,100 million in 1970 to less than \$600 million in 1971; the capital account will continue in surplus. This improvement reflects the probable effects of tighter government controls on the South African economy. Nevertheless, the existence of a deficit implies that South Africa can be expected to supply another approximately 390 tons of gold (about \$440 million calculated at \$35 per ounce) during the last four months of 1971. Because of the stability of production levels, prospects of higher market prices will not produce increases in the supply of newly-mined South African (or other Free World) gold. Consequently, the Free World's output of gold will be approximately 1,300 metric tons, about the same as in 1970.

12. Although the US suspension of gold sales has created considerable uncertainty regarding the continued operation of the two-tier system, Pretoria thus far has given no indication of a change in its sales policy. The IMF stands ready to purchase South African gold; but, with a high free market premium, Pretoria is generally not going to avail itself of this option. Indeed, according to the available information, South African sales in late August and early September followed the country's established pattern. With market prices above \$40 per fine ounce and little or no possibility of an increase in the official price to this level -- even a 10% increase would leave the price at \$38.50 per ounce -- South Africa is very unlikely to restrict sales now. Moreover, when the major currencies are realigned, speculative demand for gold should be substantially reduced, at least initially, with a concurrent fall in the market price. South Africa can take advantage of the higher prices, however, only by drawing down its gold reserves -- now at their lowest level since 1966 -- as production cannot be rapidly expanded. Meanwhile, the Swiss commercial banks probably are not restricting sales significantly as they have done in the past. If they were, gold prices would most likely be much higher.

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